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SUBJECT: MADAGASCAR'S ECONOMY: LOWER REVENUES AND SHIFTING
PRIORITIES

11. (SBU) SUMMARY: Madagascar's ongoing political crisis continues to negatively impact key macroeconomic indicators and the business sector. Customs duties collected during the first quarter were lower than predicted, and the plummet in tourism is pushing national airline Air Madagascar towards bankruptcy. The ariary continues to depreciate, but the impact on inflation is temporarily offset by a current decrease in rice prices during the harvest season. The government's first quarter spending habits (mostly under former President Ravalomanana) have led the World Bank to call for a focus on social and infrastructure spending over "political spending", but there is little indication so far that the High Transitional Authority (HAT) is listening. END SUMMARY.

12. (SBU) MARCH HARVEST LEADS TO LOW INFLATION
Prices remained stable in March, with monthly inflation estimated at 0.4 percent (compared to 1.83 percent in February). This stability is due to the decrease in the price of rice since the beginning of the current harvest period, which began in March. From March 2 to March 30, the price of locally produced rice fell by 5 percent. Inflation for the first quarter of 2009 is estimated at 3.2 percent, compared to 2.7 percent during the same period in 2008.

13. (SBU) ARIARY CONTINUES ITS FALL
During April, the ariary depreciated by 6.33 percent against the dollar and 4.29 percent against the euro; depreciation in March was respectively 2.25 percent and 7 percent against the dollar and the euro. Purchasing of euros on the foreign exchange market dropped from EUR 64.7 million in March to 63.8 millions (a 1.4 percent decline), and USD 110.13 million to 107.8 million (a 2.3 per cent decline) for dollars.

14. (SBU) Q1 CUSTOMS DUTIES LOWER THAN EXPECTED
Customs duties collected during the first quarter of 2009 were only 64 percent of budget predictions: USD 88.4 million of the USD 137.8 million target was collected. The decrease in imports and the fall in oil prices were key factors in the lower revenue.

15. (SBU) FALL IN TOURISM IMPACTS AIR MADAGASCAR
During the first quarter of 2009, Air Madagascar earned only half of predicted revenue, due to the fall in tourism. As a result, the company is likely to be incapable of paying current expenditures, particularly salaries. In addition to the crisis, the HAT Minister of Transportation accused the former (foreign) managers of Air Madagascar, as well as the "open sky policy" (permitting foreign competition on international routes to/from Madagascar), of having caused the company's bankruptcy. Note that in July 2008, the GOM budgeted USD 10.2 million for transfer directly to Air Madagascar as a means of "increasing the state's participation in the equity of the company".

16. (SBU) QMM CONTRACT UNDER REVIEW
The HAT government has announced that French company Drake and Bart (which is largely unknown) will carry out an assessment of the

contract between the GOM and Rio Tinto's QMM mining operation in Fort Dauphin. The objective is the eventual revision of the contract, given that "QMM has no development impact on the population on the ground" according to the HAT Prime Minister Roindifo Monja. (NOTE: Sources close to the Sherritt mining project near Tamatave, which faces a similar review, assert that the HAT lacks the legal authority to do so, since a revision would require changes to the law governing such investments. With parliament currently suspended, any changes would rely on a legally-questionable presidential decree. END NOTE.) Separately, local media report that due to the global financial crisis and tough situation on the international commodities market, QMM is planning to cut costs this year. As a result, QMM's purchases from local suppliers (mainly expendable supplies) will be reduced, but no job cuts are planned for full-time employees.

17. (SBU) COMMENT: Madagascar's embattled transition government will be faced with tough choices in the coming months as their revenues wither from reduced trade, declining investment and foreign assistance, and the dying tourist industry. A recent World Bank analysis found that overall GOM spending in the first quarter of 2009 (mostly under former President Ravalomanana) was down by 1/3 compared to 2008, due to the "quasi-paralysis" of public administration and growing budget constraints. Within that reduced overall spending, there was also a sizable shift away from infrastructure and social spending towards "political spending" (led by the Presidency, the Prime Minister's Office, and the Ministry of Finance, but also including Parliament and the High Constitutional Court), with the former down by over 50 percent and the latter up by almost 100 percent. The World Bank recommends reversing this trend, but the HAT's anxiety to shore up popular support makes it unlikely they will heed this advice in the short term. END COMMENT.

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